

***United States Court of Appeals
for the Second Circuit***



APPELLEE'S BRIEF

75-7648

To be argued by
GEORGE A. DAVIDSON

United States Court of Appeals
FOR THE SECOND CIRCUIT

IN THE MATTER OF
WEIS SECURITIES, INC.,

Debtor.

STOCK CLEARING CORPORATION,

Plaintiff-Appellant,

—against—

EDWARD S. REDINGTON, as Trustee
of Weis Securities, Inc.,

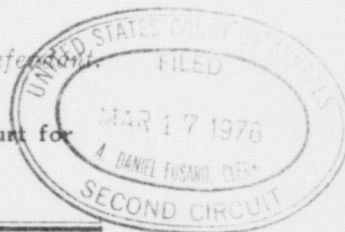
Defendant-Appellee,

and

WEIS SECURITIES, INC.,

Defendants.

On Appeal From the United States District Court for
The Southern District of New York



BRIEF OF DEFENDANT-APPELLEE
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On Appeal from the United States District
Court for the Southern District of New York

BRIEF OF DEFENDANT-APPELLEE
EDWARD S. REDINGTON

Preliminary Statement

This brief is submitted on behalf of defendant-appellee Edward S. Redington, As Trustee of Weis Securities, Inc. (the "Trustee"), in opposition to the appeal of plaintiff-appellant Stock Clearing Corporation ("SCC") from an order of the United States District Court for the Southern District of New York, Inzer B. Wyatt, Judge, entered October 28, 1975, affirming an order of the Bankruptcy Court, Roy Babitt, Bankruptcy Judge, entered June 13, 1975, which dismissed SCC's complaint for reclamation.* Judge Wyatt's opinion is set forth in the Joint Appendix beginning at page A173 and Judge Babitt's opinion is set forth beginning at page A158. Neither opinion is officially reported.

Questions Presented

1. Whether the district court was required to order a post-trial hearing in this case.
2. Whether the district court was correct in holding that SCC had no right of reclamation.

* Although Weis Securities, Inc. ("Weis") is named by SCC in the caption as a defendant-appellee, Weis has never appeared in the action.

Statement of the Case

SCC is a wholly-owned subsidiary of the New York Stock Exchange which provides a central facility for the delivery of stock certificates between brokers (A100). Weis Securities, Inc. ("Weis") was a brokerage firm and a member of SCC.

On May 24, 1973, the last day Weis was in business, Weis gave SCC a check for \$1,135,459.87 in payment of its debit balance under SCC rules. The check was dishonored. In this proceeding, SCC seeks reclamation of securities delivered to Weis by other brokers through SCC facilities on May 24, 1973, sufficient in value to equal the amount of the dishonored check.

Proceedings Below

SCC first advanced its reclamation claim on June 15, 1973, when SCC sought by order to show cause in the bankruptcy court to restrain the Trustee from disposing of securities which Weis had received from other brokers through SCC on May 24. SCC and the Trustee thereafter entered into a stipulation under which the Trustee was permitted to dispose of the securities but agreed to segregate a fund of \$1,135,459.87 against which any rights SCC might have to the securities could operate (A14-A19). For clarity, this brief is written as if the securities remained intact and the fund had not been substituted for them.

SCC filed its complaint in the bankruptcy court on May 20, 1974. In the first count, SCC alleged that Weis' failure to pay its debit balance to SCC gave SCC the right to reclaim securities delivered to Weis through SCC. In a second count, SCC alleged that Weis had obtained the securities by fraud, but that count was later dismissed with prejudice by stipulation (A29).

After taking the depositions of five witnesses, counsel for SCC and the Trustee agreed upon a record. A stipulation was signed containing agreed-upon facts and several exhibits and providing that the five depositions could be used by any party for any purpose. On the date set for trial, the parties presented the stipulation to Judge Babitt, filed briefs, and argued the case on the merits. The Trustee offered several reasons why SCC was not entitled to reclamation, including SCC's lack of any ownership or other possessory interest in the securities and the credit nature of the transaction involved. On June 13, 1975 Judge Babitt filed an opinion and order dismissing the complaint. Holding in favor of the Trustee on the issue of SCC's lack of possessory interest, Judge Babitt was not required to reach the credit issue. On appeal, the District Court affirmed. Noting that Judge Babitt's ruling seemed "sound" (A179), Judge Wyatt held that reclamation was unavailable even if SCC had a possessory interest because the transaction was a credit transaction.

Statement of Facts

SCC's Relationship To Weis

As a member of SCC, Weis was a party to a Clearing Member's Agreement providing that the SCC By-Laws and the SCC Rules would govern every transactions between Weis and SCC (A30). The parties have stipulated that the relevant transaction between SCC and Weis were transacted subject to the Clearing Member's Agreement and SCC's By-Laws and Rules* (A27).

The Functions And Operations Of SCC

After a contract to sell a particular security at a particular price is made on the floor of the New York Stock Exchange ("NYSE"), there remains the task of physically exchanging the stock certificate and the money to be paid for the stock. Perhaps the best way to describe SCC's role in effectuating this exchange is with a simple example.

Let us assume that on a certain day broker X has sold 100 shares of Bethlehem Steel for each of ten different customers and has purchased 100 shares of Bethlehem Steel for each of eleven different customers. Let us assume also that each of

* Since SCC changed its rules subsequent to the transactions at issue here, the version of the rules reprinted in the Joint Appendix beginning at p. A37 should be consulted rather than the version contained in the CCH New York Stock Exchange Guide.

these sales and purchases was made to or from a different broker. Without SCC, broker X would have to undertake twenty-one separate exchanges of the stock certificates and the purchase prices. Moreover, broker X would have to pay cash for all of the stock purchased. Because of the delay in reducing to cash the checks given in payment for stock sold, proceeds of sales would be an inadequate source of cash for purchasing purposes, and short term "day loans" would have to be obtained to cover the purchases. With the advent of SCC, (1) the number of deliveries and payments was substantially reduced, and (2) much of the credit formerly supplied by day loans was replaced by credit extended by SCC.

SCC accomplishes these results through three functions it performs for its members -- clearing, delivery, and settlement.

Clearing

With a clearing corporation such as SCC, the multiplicity of exchanges of certificates in the example stated above is eliminated. In what is called the "clearing" process, trades are matched by SCC so as to minimize deliveries. Thus, broker X, who has sold 100 shares of Bethlehem Steel for each of ten customers and has purchased 100 shares of Bethlehem Steel for

each of eleven customers, can make delivery of the stock to ten of his eleven purchasers by using the stock of those who sold. Broker X needs then to receive only 100 shares from other brokers.

Based on information as to NYSE trades for each day submitted to it by its members, SCC compares all the trades for each security for that day and issues "balance orders" to its members who have made trades in that security. The balance order states that on the fifth business day after the day of the trade, the member should deliver to or receive from another member a specified number of shares of that security (Rule 5, A41-A42).

Delivery

The deliveries of securities pursuant to the balance orders described above are made through the facilities of SCC (Rule 6, A42-A47). In addition, SCC members are permitted to use the facilities of SCC for the delivery of securities and other items pursuant to other transactions between them and other members of SCC. For example, on May 24, 1973 other brokers used SCC facilities to deliver to Weis such things as stock previously borrowed from Weis, securities in customer accounts which were being transferred from other brokers to Weis, and

marks-to-market, which are not securities at all but are in effect bills rendered in stock loan transactions to keep the amount of the loan in line with the market value of the stock (A68-A69).

To deliver a security or other item through SCC, the delivering member places the item in an envelope and writes on the outside of the envelope the identification number of the receiving member and the total dollar amount of the items in the envelope (A78-A79). The delivering member then takes the envelope to the Central Delivery Department of SCC. With each group of envelopes, the delivering member also brings duplicate credit lists listing the envelopes being delivered and the information written on the outside of those envelopes (Rule 6, § 1(3), A43). An SCC clerk time stamps the duplicate credit lists and returns one of them to the delivering member. The clerk then sorts the envelopes into the cubicles maintained in the Central Delivery Department for the receiving members (Rule 6, § 1(6), A43-A44; A81). The clerk does not look inside the envelopes (A81). The receiving members then pick up their envelopes from their cubicles (Rule 6, § 1(8), A44).

Time of Deliveries

Items scheduled for delivery on a particular day may be brought by the delivering member to SCC during the

evening of the preceding day and up to 11:30 A.M. on the day of delivery (A79). In addition, receiving members can return irregular items to the delivering member through SCC up to 2:00 P.M. on the day of delivery (Rule 6, § 1(9), A44).

The receiving broker may pick up items scheduled for delivery on a particular day beginning at 8:00 A.M. on that day (A81-A82; Rule 6, § 1(8), A44).

Settlement

In the case of payments, SCC provides even greater savings to broker X than it does in the case of deliveries. As noted above, broker X would have had to receive ten payments and to make eleven payments in respect of his Bethlehem Steel trades. Further, he would have had to take a day loan to finance the payments he was required to make. In what is called its "settlement" function, SCC gives broker X several advantages:

1. he need not pay for any securities at the time he receives them;

2. he is permitted to treat as payment all securities (and, indeed, all other items) he has delivered out through SCC on the same day.

(Thus, the delay and expense of reducing to cash the payments for securities sold is avoided);

3. SCC agrees to pay all amounts due to other brokers in respect of securities delivered to him; and

4. if his deliveries received during a particular day exceed his deliveries out, he must pay SCC the difference, but need not pay SCC until 3 P.M. on that day -- up to seven hours after he has begun to receive securities. Under this scheme, broker X's need for bank financing is substantially reduced or eliminated, since he has received credit from SCC.

The details of the settlement process are as follows: at the time SCC stamps the credit list of the delivering member, it credits the delivering member's SCC account with the dollar amount of each envelope listed on the credit list and debits the receiving member's SCC account in the same amount (Rule 6, § 1(7), A44). In addition, the Settlement Department debits or credits a member's account for amounts payable or receivable pursuant to other SCC Rules (See Rules 5, 6, 7, 9, 10, 11, 12, 20, 21 and 22, A41-A54, A58-A61). Thus, Weis' debit balance on May 24 included amounts for New York State transfer taxes and a clearance cash adjustment.*

* For the purpose of matching trades and minimizing deliveries in preparing its "balance orders", SCC arbitrarily assumes that all trades in a particular security on a particular day were made at the same price. The clearance cash adjustment is the money difference between the arbitrarily assumed prices and the actual prices at which a particular broker made his trades (See Rule 5, § 3, A41; A28).

At the close of business, the debits and credits for the day of each member are tallied. If a member's total debits exceed its total credits, the member must deliver to SCC a check in the amount of the debit balance by 3:00 P.M. on that day (Rule 7, A47-A48). The check must be certified if the debit balance exceeds \$5,000. If, on the other hand, the member's total credits exceed its total debits SCC will give the member an SCC draft in the amount of the credit balance by 3:00 P.M. (Rule 7, A47-A48).

SCC makes payments to members with credit balances without waiting for receipt of checks from members having debit balances (A95). SCC is able to issue its drafts to members with credit balances without waiting to collect checks due from members with debit balances because of its Clearing Fund (A32-A36). This fund permitted SCC to pay all its members with credit balances on May 24 even though Weis' obligation for that day remains unpaid. Financed by contributions required from members, the Clearing Fund provides a guarantee to members that any amounts due them in respect of deliveries completed through SCC will be paid even if another member becomes insolvent.

SCC Rules provided several devices by which SCC could protect itself from a member's failure or inability to meet its obligations to SCC. Rules 6 and 13 provided a lien on securities destined or held for members while those securities were in SCC's possession (A44-A45; A55). Rule 7 provided that SCC could

require a member to post additional security to secure its commitments to SCC and required members to conform to any conditions which SCC deemed necessary for its own protection (A47-A48). Rule 7 also permitted SCC to accelerate the time for the payment of a member's debit balance by demanding immediate payment (A47). And Rule 14 gave SCC discretion to cease acting for a member (A55).*

The Events of May 24

With this background in the operations of SCC, we turn to the events of May 24, 1973. As noted above, securities to be picked up by Weis on May 24 would have been brought to SCC beginning on the evening of May 23.

On the morning of May 24, the Daily News reported problems at Weis (A120). On the same morning SCC's Executive Vice President chaired a meeting at which SCC and SIAC** employees were told that Weis was in trouble but that they were to "make sure that everything went all right that day in the normal manner, business manner" (A87). An SCC officer and an SCC director attended another meeting that morning at the New York Stock Exchange to discuss the Weis situation and the possibilities for keeping Weis open in the future (A146; A152-A153).

* In addition, Article XI, § 3 of the NYSE Constitution gave SCC second priority on the proceeds of the sale of the member's NYSE memberships after any debts of the member to the NYSE were satisfied.

**SIAC, or Securities Industry Automation Corporation, is an organization to which SCC has delegated a number of operating functions (A77).

Over the course of the day, Weis messengers made deliveries of envelopes to other brokers through SCC and picked up envelopes intended for Weis. As was its practice, Weis used a portion of the securities received through SCC on May 24 for deliveries out to other brokers on the same day (A49-A50; A67; A69).

By the close of business on May 24, Weis owed SCC \$1,135,459.87, the difference between debits in its account at SCC of \$1,918,388.46 (representing the value of securities and other items received through SCC and stock transfer taxes) and credits of \$782,928.59 (representing the value of securities and other items delivered out through SCC) (A27-A28).

At approximately 4:00 P.M. on May 24, Mr. Petroski of STAC was advised by an employee of Weis that Weis would be unable to deliver a certified check to SCC for the amount owed as required by SCC Rules because Weis' bank had "frozen" Weis' account (A91-A94). After receiving this call, Mr. Petroski contacted an officer of SCC who instructed him to accept an uncertified check from Weis for that day's settlement (A93). SCC then accepted the check, but the next day SCC was informed that the check would not be honored (A28-A29).

ARGUMENT

POINT I. THE COURTS BELOW WERE
NOT REQUIRED TO ORDER
A FURTHER HEARING

SCC's appeal is based on a fundamental mischaracterization of the procedural posture of this case in the courts below. This case was not decided on a motion for summary judgment; it was decided after trial on a stipulated record. Neither party made any motion for summary judgment.

After discovery, the parties were able to agree on a record, consisting of stipulated facts, exhibits, and the transcripts of five depositions. On the date scheduled for trial, the parties presented a stipulation to Judge Babitt setting forth the record, submitted briefs, and argued the case on the merits. The Trustee's brief noted that "The parties have agreed upon a record, and the case is ready for decision" (Trustee's Memorandum in Opposition to Stock Clearing Corporation Reclamation Claim, p. 1; footnote omitted). At oral argument, Judge Babitt referred to the stipulation setting forth the record and asked "are there any other material facts as to which I will need evidence?" The Trustee's counsel replied, "Your Honor, I believe that's the complete record" (A156).

Judge Babitt went on to characterize the posture of the case as "basically a motion for summary judgment by both sides"* (A156). Of course, what really occurred was a trial on a stipulated record, as Judge Babitt implicitly recognized when he noted at the argument that his options were to grant the relief sought by SCC or to dismiss the complaint (A157). Later in his written opinion, Judge Babitt found that SCC had failed to sustain its burden of proof, and therefore he dismissed the complaint (A166).

SCC's claim that there are additional facts which had to be examined if the court did not grant judgment for SCC is wholly inconsistent with a trial on a stipulated record and is of very recent manufacture. In its brief on appeal to Judge Wyatt, SCC wrote that Judge Babitt's decision:

"* * * was rendered after oral argument by the parties based upon an agreed stipulation of facts which is a part of the record before this Court. * * * Because there is no dispute as to the facts, the legal issues presented to the Court below, including the question of standing, are now properly before this Court." (SCC's Memorandum On Appeal In Support of Reclamation, pp. 1-2).

* Even if the parties had made cross-motions for summary judgment, SCC could not prevail. While the fact that both sides have moved for summary judgment does not ordinarily preclude a finding of triable issues of fact, the rule is otherwise where the parties have stipulated the facts. See Demelle v. Interstate Commerce Commission, 219 F.2d 619 (1st Cir.), cert. denied, 350 U.S. 824 (1955).

Again at oral argument of the appeal, the following colloquy between Judge Wyatt and SCC's counsel took place:

THE COURT: If I decided you have standing do I send it back to Referee Babitt or do I then go ahead and decide the merits?

MR. JEROME: We think at this point in time I would be perfectly willing to have the court make the decision.

THE COURT: But what is appropriate?

MR. JEROME: I think it would be appropriate that because we are up in a stipulation of facts, as I indicated in my brief, that the entire issue be decided." (A171-A172).

In deciding the credit issue, Judge Wyatt resolved the question that SCC had characterized as the central issue both in the bankruptcy court and in the district court (A171). SCC chose what evidence to present on the credit issue and cannot legitimately charge Judge Wyatt with error in resolving the issue without holding a further hearing.

POINT II. THE COURTS BELOW CORRECTLY HELD THAT
SCC HAD NO RIGHT OF RECLAMATION

The issue presented to the courts below was not whether Weis owes SCC \$1,135,459.87. There is no question that it does. Weis, however, is bankrupt and cannot meet its obligations to its numerous creditors. The issue was whether SCC had a right in preference to all other creditors, including securities customers, to be made whole by obtaining property from Weis equal in value to Weis' debt to it. The reclamation remedy which SCC sought is an extraordinary one, and courts have imposed a strict burden of proof on claimants to establish all the elements of a reclamation claim. Allen v. Lokey, 307 F.2d 353, 354 (5th Cir. 1962); In re Heintz-Merkle & Co., 1 F.Supp. 531, 536 (E.D. Pa.), aff'd sub. nom. Brockway Motor Truck Corp. v. Friedman, 61 F.2d 519 (3d Cir. 1932); In re Fairfield Elevator Co., 14 UCC Rep. Serv. 96, 104 (S.D. Iowa 1973) (not officially reported); In re Lux's Superette, Inc., 206 F.Supp. 368, 369 (E.D. Pa. 1962); In re Meagher, 35 F.Supp. 58, 60 (E.D. Pa. 1940).

SCC could not and did not establish a right to reclamation. As Judge Babitt held, SCC could not maintain a reclamation claim because it lacked the necessary ownership or other possessory interest in the securities. Judge Wyatt noted that this ruling seemed "sound" (A179) but held that SCC could not have prevailed even if it had standing because Weis had received the securities in a credit transaction.

Since the question of whether SCC had the necessary possessory interest is a threshold issue, we begin with an analysis of that issue.

A. SCC Failed to Establish The Possessory Interest Required to Maintain a Claim for Reclamation

The theoretical basis of a reclamation claim is that certain property found with the bankrupt actually belonged to the claimant and should be returned to the claimant rather than be reduced to cash and divided among the bankrupt's creditors. Thus, the hornbook rule is that a reclamation claimant must establish that he is the owner of property in the hands of the bankrupt or the trustee. See, e.g., Allen v. Lokey, 307 F.2d 353, 354 (5th Cir. 1962); Salkind v. Dubois, 105 F.2d 640, 642 (3d Cir. 1940); General Phonograph Corp. v. Fanning, 6 F.2d 115, 116 (3d Cir. 1925); In re Heintz-Merkle & Co., 1 F.Supp. 531, 536 (E.D. Pa.), aff'd sub nom. Brockway Motor Trust Corp. v. Friedman, 61 F.2d 519 (3d Cir. 1932); In re Fairfield Elevator Co., 14 UCC Rep. Serv. 96, 103-04 (S.D. Iowa 1983) (not officially reported); In re Lux's Superette, Inc., 206 F.Supp. 368, 369 (E.D. Pa. 1962); 4A Collier, Bankruptcy ¶ 70.39[3], at 476-77 (14th ed. 1971). See also Hagan v. Gardner, 283 F.2d 643, 645 (9th Cir. 1960).

Here it was quite clear that SCC never had title to the securities which Weis received through SCC's facilities.

It was not SCC which had bought and sold securities on the New York Stock Exchange floor; it was securities brokers who had done so. As for the stock certificates, SCC merely provided a sorting service for the benefit of securities brokers using its services. SCC's own Rules made it quite clear that SCC was not the owner of securities delivered through its facilities. Thus, SCC Rules provided that envelopes held by it were "held . . . for the delivering" member prior to the time SCC stamped the credit list accompanying the envelopes and "held . . . for the receiving" member thereafter (Rule 6, § 1(5), A43). At no point did SCC hold the envelopes on its own behalf. The Rules also made it clear that SCC did not even know what was inside the envelopes delivered through its facilities (Rule 6, § 1(6), A43-A44).

Furthermore, SCC's Rules provided that SCC had a lien on all securities held by it for a member for all amounts due to be paid to SCC by that member* (Rule 13, A55). This provision clearly recognized that SCC was not the owner of the securities delivered to Weis, for it would have been meaningless to grant SCC a lien on property that SCC already owned.

* Of course, this lien was lost when Weis picked up the securities from SCC. See, e.g., National City Bank v. Hotchkiss, 231 U.S. 50, 57 (1913).

Although SCC's brief is oddly silent on the question of possessory interest, SCC appears to have abandoned the argument that it was the owner of the securities and to assert now that it has a right to reclaim as a subrogee and as a bailee. Neither of these characterizations can give SCC standing.

1. SCC Cannot Reclaim as a Subrogee

SCC cannot reclaim as a subrogee because SCC has no right of subrogation. SCC's contract provided particular security for Weis' obligations to SCC. The cases recognize that where, as here, a would-be subrogee has contractually carved out particular collateral or security to secure the obligation of the debtor, he cannot rely on the doctrine of subrogation to succeed to the additional rights or security of the creditor who was paid through the use of his funds. See, e.g., Capen v. Carrison, 193 Mo. 335, 92 S.W. 368 (1906); Ganger v. Moffett, 8 N.J. 73, 83 A.2d 769 (1951); Buskirk v. State-Planters' Bank & Trust Co., 113 W. Va. 764, 767, 169 S.E. 738, 739 (1933); 83 C.J.S. Subrogation § 3 at 585 (1953); see also In re Rogers Palace Laundry Co., 275 F. 829, 830 (7th Cir. 1921); cf. Gilman v. Brown, 10 F. Cas. 392, 400 (No. 5,441) (C.C. Mass. 1817) (Story, J.), aff'd, 17 U.S. (4 Wheat.) 255 (1819).

Here the Rules spelled out in detail exactly what collateral SCC was given for the debit balances of members.

Rule 6, § 1 (11) gave SCC a lien on any property destined for a member with a debit balance which was delivered to SCC by another member (A44-A45). In addition, Rule 13 afforded SCC a lien on any and all securities held by it at any time for the account of a member with a debit balance (A55).^{*} SCC could have sold or pledged the securities subject to its liens to satisfy the debit balance of a member. What was not granted to SCC under the Rules was a lien on securities no longer in its possession. Having contracted for particular security, SCC may not invoke the doctrine of subrogation to claim additional security.^{**}

^{*} In addition, Article XI, § 3 of the NYSE Constitution gives SCC a second priority lien on the proceeds of sale of all of the member's NYSE memberships.

^{**} Furthermore, as a discretionary equitable principle, subrogation will not be invoked to subvert or impair the existing legal or equitable rights of other claimants to the property in issue. See 2 Story, Equity Jurisprudence § 707, at 111 (14th ed. 1918); Sheldon, Subrogation § 4, at 5 (2d ed. 1893); Strickland v. Magoun, 119 App. Div. 113, 117, 104 N.Y.S. 425, 428 (2d Dep't 1907). In Strickland, a creditor who had discharged a debt of a bankrupt broker to a bank argued that it was subrogated to the rights of the bank in respect of certain securities held by the bank. The securities held by the bank, however, were attributable to the margin account of a customer of the bankrupt. The court held that the equities of the customer were at least equal to those of the claimant and that the customer's equities should not be sacrificed to the claimant even though the bank would have prevailed over the customer. In this case, as will be shown in II.C., *infra*, customers of Weis acquired an interest in most of the securities delivered to Weis through SCC's facilities. Equity will not permit SCC to invoke subrogation to defeat these rights.

2. SCC Cannot Reclaim as a Bailee

There is little law on the question whether a bailee has standing to reclaim. But even if it is conceded that a bailee does have standing to reclaim property wrongfully seized from him, see Bradley v. St. Louis Terminal Warehouse Co., 189 F.2d 818 (8th Cir. 1951), SCC cannot reclaim here. For when a bailee terminates the bailment by re-delivering the property to the bailor, see Pan-American Petroleum Transportation Co. v. Robins Dry Dock & Repair Co., 281 F. 97, 107 (2d Cir.), cert. denied, 259 U.S. 586 (1922), or by delivering the property to a third person pursuant to the bailor's instructions, see Mays v. New York, New Haven & H.R.R. Co., 197 Misc. 1062, 1064, 97 N.Y.S.2d 909, 912 (App. Term 1st Dep't 1950), he has lost his status as a bailee and no longer has standing to reclaim. When SCC placed the envelopes intended for Weis in Weis' cubicle pursuant to the instructions of the delivering members and permitted Weis to pick up the envelopes, the bailment ended. With its voluntary relinquishment of possession,* SCC gave up its status as a bailee and cannot now seek reclamation as a bailee. See Mays v. New York, New Haven & H.R.R. Co., 197 Misc. 1062, 1064, 97 N.Y.S.2d 909, 912 (App. Term 1st Dep't 1950).

* It is noteworthy that SCC does not claim that Weis deceived it into surrendering ownership of the securities. The fraud claim originally contained in SCC's complaint was dismissed with prejudice by stipulation of the parties (A29).

There is no question that Weis was contractually obligated to pay its debit balance of \$1,135,459.87 to SCC on May 24, 1973. Having not been paid, SCC is certainly free to file a claim as a general creditor of Weis. However, SCC has no ownership interest in the securities delivered to Weis through SCC facilities and is not entitled to preferential treatment over other creditors by reclamation of property it never owned.*

*The fact that SCC does not and never did own the securities and other items delivered through its facilities is also fatal to SCC's claim to the contents of envelopes valued at \$61,300 which were delivered to Weis after the filing of the petition against Weis under the Securities Investor Protection Act. SCC has argued in Point III of its brief that neither the Trustee nor Weis could obtain title to those items. The merits of SCC's argument are irrelevant in view of SCC's failure to establish its own title, since it is settled that "a petitioner for reclamation is entitled to succeed only on the strength of his own right to the property" and not on the alleged "weakness of that of the bankrupt or the trustee." 4A Collier, Bankruptcy § 70.39, at 467 n.7 (14th ed. 1971); Robbins v. Bostian, 138 F.2d 622, 625 (8th Cir. 1943); In re Fairfield Elevator Co., 14 UCC Rep. Serv. 96, 104 (S.D. Iowa 1973) (not officially reported).

In any event, SCC's argument fails because, contrary to SCC's assumption, the envelopes did not contain securities sold to Weis. Rather, \$56,800 of the total consisted of stock which had been borrowed from Weis and was being returned (Stipulation Exh. D, items 33, 62, 66, A63, A65). Weis did not need to acquire title to this stock, for it already owned it. The remaining \$4500 consisted of "marks-to-market" which are merely bills rendered by other brokers in stock loan transactions; they do not constitute property and are therefore not reclaimable (Stipulation Exh. D, item 26, A63).

B. SCC Cannot Reclaim The Securities
Because The Transaction Was a
Credit Transaction

The reclamation theory on which SCC relies -- the old "reservation of title" doctrine -- applied only to cash transactions. It follows that SCC had no right of reclamation if (a) the transaction was initially a credit transaction or (b) it began as a cash transaction but was thereafter converted into a credit transaction. Judge Wyatt held that the transaction was a credit transaction because SCC had extended credit to Weis prior to the time Weis was required to make payment. This conclusion is indisputably correct. However, even if the transaction had been a cash transaction, it was converted to a credit transaction when SCC agreed to accept a check drawn on a bank account that it knew had been frozen.

1. The Transaction Between SCC and
Weis Began as a Credit Transaction

SCC has claimed that the transaction between it and Weis was a cash transaction despite a several hour delay between delivery and payment, citing the case of In re Perpall, 256 F.758 (2d Cir. 1919), and a few sales of goods

cases.* This argument ignores the substance of the relationship between SCC and its members.

Analysis of SCC's operations demonstrates that the settlement procedure culminating in a member's obligation to repay its debit balance is, in fact, an intra-day extension of credit by SCC comparable to the day loans which were held to be extensions of credit in National City Bank v. Hotchkiss, 231 U.S. 50 (1913), and, ironically, in In re Perpall, 261 F. 858 (2d Cir. 1919) ("Perpall II").** Indeed, the granting of such credit is one of the principal functions of SCC.

The purpose of the broker's day loan is described in Meyer, The Law of Stock Brokers and Stock Exchanges (1931):

"Prior to the establishment of the Stock Clearing Corporation by the New York Stock Exchange, it was the practice for brokers in New York and elsewhere to obtain 'clearance loans' or 'day loans' from their banks in order to enable them to pay for securities which they had purchased for the account of their customers or for their own account. The 'day loan' would be made

* While the Trustee does not believe that the case of In re Samuels, 510 F.2d 139 (5th Cir. 1975), relied on by SCC, is either controlling or correctly decided, the Trustee does wish to advise the court that the Fifth Circuit has granted rehearing en banc of the 2 - 1 decision of the panel in that case.

** This case has been denominated Perpall II to distinguish it from the cash seller Perpall cases on which SCC principally relies.

early in the day, and would be repaid later in the day when the broker received payment for the securities purchased, or if not so repaid, would be secured by the securities which had been paid for with the proceeds of the loan." At 613 (emphasis added).

The "day loan" or "clearance loan" was also explained in the leading Supreme Court case of National City Bank v. Hotchkiss, 231 U.S. 50 (1913):

"The case arose upon what is known in New York as a clearance loan. Brokers need large sums to clear or pay for the stocks that they receive in the course of the day, and as the stocks must be paid for before they are received and can be pledged to raise the necessary funds, these sums are advanced by the banks. They are returned later on the same day by making deposits to the borrower's account and drawing a check to the order of the bank." 231 U.S. at 55.

In Hotchkiss, the broker became insolvent several hours after the loan had been extended to it, but prior to repayment. The Court held that the loan, albeit shortlived, constituted an extension of credit and that the repayment following insolvency was a preference:

"* * * The consent to become a general creditor for an hour, that was imported, even if not intended to have that effect, by the liberty allowed to the firm, broke the continuity and established the loan as part of the assets. No doubt many general creditors have increased a bankrupt's estate by their advances, but they have lost the right to take them back." 231 U.S. at 58.

In Hotchkiss, followed in Perpall II, the Supreme Court held that where payment was made only a few hours after an obligation was incurred the transaction was a credit transaction, while the court in the first Perpall case, 256 F. 758 (2d Cir. 1919), reached the opposite result. How are the cases to be reconciled? The key is intent. In the first Perpall case, a messenger delivering a bond pursuant to a cash sale left the bond with the buyer while the bond was inspected and the check was prepared; the messenger continued with other errands and a fellow messenger returned later to pick up the check. In holding that no credit had been extended, the court noted that:

"From the circumstances here present, no intent or purpose to extend credit to the bankrupt arises. The claimant is in no worse position than he would have been in, had the messenger idled away his time in the office of the bankrupt while waiting for the details of making the entries and drawing the check to be completed." 256 F. 760-61 (emphasis added).

Here, as in Perpall II, the very purpose of the entire operation is to extend credit. As indicated by the underscored portion of the quote from Meyer, supra pp. 25-26, the creation of Stock Clearing Corporation has obviated the need for the day loan.

On May 24, 1973, brokers delivered several hundred thousand dollars worth of securities to a firm which had been

reported in the press to be in financial trouble, without demanding contemporaneous payment (A27; A120). Why did they take such a risk? Because they could count on the credit of SCC. A broker delivering securities through SCC had no need to demand cash payment from the receiving broker prior to the release of securities because he was assured under Rule 7 that his credit balance, if any, would be paid by SCC at 3:00 P.M. on the delivery date (A47). There can be no question that by guaranteeing the payment of credit balances arising from the deliveries to its members, SCC was extending intra-day credit to the recipients of the deliveries. See In re Lyon, 121 F. 723, 725 (2d Cir. 1903); Swarts v. Siegel, 117 F. 13, 17 (8th Cir. 1902) ("One who loans his credit to another is as much his creditor as one who loans his money to him."); Cooper Petroleum Co. v. Hart, 379 F.2d 777, 780 (5th Cir. 1967); see also Smith v. Tostevin, 247 F. 102-03 (2d Cir. 1917); 3 Collier, Bankruptcy ¶ 60.17, at 836 (14th ed. 1971). The situation is no different than if the bank in either Perpall II or Hotchkiss, instead of making the cash immediately available to the broker, obligated itself to make payment for stock which the broker would receive over the course of the day. This is credit, pure and simple. SCC was able to extend credit in this fashion because its Clearing Fund (a fund comprised of mandatory contributions by members) was available to pay for any losses

which might be sustained by reason of the non-payment of member debit balances (A32-A36).

The passage from the Meyer treatise previously quoted suggests that SCC replaces the broker's day loan. Analysis of the debit balance settlement process confirms that this is so.

SCC's own Rules treated the members' debit balances as the equivalent of day loans, for the Rules contained a number of provisions typical of a loan agreement:

Rule 6* and 13** gave SCC liens on stock and other property of members in its possession as security for its loan.

* Rule 6 § 1(11) provided: "The Corporation shall have a lien for any debit balance due it by a receiving * * * Member on any property delivered to the Corporation or which may come into its possession as a result of deliveries made by other * * * Members through the Corporation and may exercise in respect thereof all the rights reserved to the Corporation under Rule 13 hereof" (A44-A45).

** Rule 13 provided: "The Corporation shall have a lien on any and all securities and other property held by it at any time * * * for the account of a * * * Member * * * for all amounts due * * * to it from said * * * Member * * * under its By-Laws or Rules. It shall have the right to * * * pledge * * * the securities or other property held by it * * *. In case a * * * Member * * * shall become insolvent * * * or shall fail to pay his debit balance * * * the Corporation may, in its discretion, cause all or any of the securities or other property held by it for his account to be sold. * * * "The proceeds of sale shall be applied by the Corporation to the payment of the * * * Member's * * * debit balance * * * " (A55).

Rule 7 gave SCC the right to accelerate or call the loan to its member.* Rule 7 also gave SCC the right to demand assurances and to impose conditions on the loan.** Rule 14 gave SCC the right to cease extending credit at any time.***

Understandably, the SCC settlement system is recognized as an extension of credit by all impartial observers. The Meyer treatise has already been mentioned. In The Stock Market Handbook's chapter on "The Clearing Corporations and the Central Certificate Service", the author observes:

"The clearing corporations have established rules for their members to insure standards of practice and uniformity of schedules. These rules frequently require a contribution from each member to finance a 'clearing fund' that would serve as a financial cushion in the event of a member insolvency. The clearing fund also acts as 'insurance' for the intra-day extensions of credit to clearing members prior to their daily settlement of net balances."
At 714-15 (emphasis added).

* "A Settling Member shall pay Stock Clearing Corporation the whole or any part of his debit balance at any time on its demand" (A47).

** "At the request of the Corporation, a * * * Member * * * shall immediately furnish it with such assurances as it shall require of his ability to finance his commitments and shall conform to any conditions which the Corporation deems necessary for its protection* * *" (A47-A48).

*** "The Corporation may, in its discretion, at any time cease to act for a * * * Member * * * either with respect to a particular transaction or transactions or to transactions generally" (A55).

Federal Reserve Board Regulation T, which provides rules as to who can extend credit to broker-dealers, also recognizes that clearing corporations extend credit:

"Credit for clearance of securities. The extension or maintenance of any credit which is maintained for only a fraction of a day (that is, for only part of the time between the beginning of business and midnight on the same day) shall be disregarded for the purposes of this part, if it is incidental to the clearance of transactions in securities directly between members of a national securities exchange or through an agency organized or employed by such members for the purpose of effecting such clearance." F.R.B. Reg. T, 12 C.F.R. § 220.6(i) (1973).

In summary, we have seen that the debit balance settlement system replaces a loan, has all the characteristics of a loan, and looks like a loan to impartial observers. SCC's argument that the transaction must have been a cash transaction since Weis was obligated to give SCC a cash payment is sophistry. Credit transactions as well as cash transactions routinely terminate in cash payments. That Weis was obligated to repay the credit extended to it by SCC "in cash" does not negate the fact that credit had been extended prior to the time payment was required. The brokers in Perpall II and Hotchkiss were also required to repay their day loans "in cash" on the afternoon of the day on which credit was extended.

In short, SCC has stepped into the shoes of the lending bank in Perpall 'I and not into those of the employer of the messenger in the first Perpall case. SCC is a creditor with no right of reclamation.

Nor can SCC obtain a right of reclamation by attempting to step into the shoes of its delivering members through subrogation. Under the SCC debit balance system, the delivering brokers had no right of reclamation because they had extended credit as well. The court in the first Perpall case made it clear that whether a transaction was to be regarded as a cash sale depended upon whether the parties intended that delivery and payment would occur at the same time:

"* * * [W]here a contract for the sale of personal property does not provide, in express terms, that payment shall be made on delivery, or that payment and delivery shall not be concurrent, the intent of the parties must control, and if from the acts of the parties and the surrounding circumstances it can be inferred that it was intended that payment and delivery should be concurrent acts, the title will be deemed to have remained in the vendor until the condition of payment is complied with."
256 F. at 759 (emphasis added).

A broker dealing through SCC had no expectation whatever that delivery and payment would be simultaneous. The broker knew that payments would not be made on settlement day until 3 P.M. even though deliveries could begin the evening before. The

broker knew that the broker to whom he delivered the securities might well deliver them out to other brokers before he was paid.* Clearly, the broker did not contemplate either that payment would occur upon delivery or that title would remain with him until payment was received. The broker contemplated a credit transaction.

2. The Transaction was Converted to a Credit Transaction When SCC Accepted an Uncertified Check on an Account It Knew to be Frozen

Even if the transactions pursuant to which SCC members were required to give settlement checks to SCC were ordinarily cash transactions, SCC cannot prevail. If the transaction between SCC and Weis on May 24 began as a cash transaction, it was transformed into a credit transaction by the actions of the parties. SCC extended credit to Weis when it accepted a Weis check drawn on a bank account which SCC knew had been frozen.

The law is clear that a transaction originally intended by the parties as a cash transaction can be converted into one for credit if the buyer upon learning that cash payment is not immediately available continues to look to the seller for payment. See In re Colacci's of America, Inc., 490 F.2d 1118, 1120-21 (10th

* Of the stock received by Weis through SCC on May 24, stock valued at more than \$150,000 was in fact delivered out from Weis on that day (Stipulation Exh. E, category 6B, A69; Stipulation Exh. D, Note 3, A67).

Cir. 1974); Motores de Mexicali v. Bank of America, 227 F.2d 643, 645 (9th Cir. 1955); Security Trust & Savings Bank v. Wm. R. Staats Co., 233 F. 514, 518 (9th Cir. 1916); Engelkes v. Farmers Co-operative Co., 194 F. Supp. 319, 325 (N.D. Iowa 1961); Wilson v. Buchenau, 43 F. Supp. 272, 277 (S.D. Cal. 1942).

Under ordinary circumstances, the law regards payment by check as cash payment. This rule can be defended on the ground that as a theoretical matter, a check can be converted into cash immediately by presenting it at the bank on which it is drawn. Cf. In re Mort Co., 208 F. Supp. 309, 310-11 (E.D. Pa. 1962). Therefore, there need not necessarily be a lapse of time between delivery of the goods sold and reduction to cash of the check given in payment.

The ordinary rule, however, does not apply in situations in which the party accepting a check in payment has reason to know that the check cannot be immediately converted into cash. In those situations, the party accepting the check is relying on the credit of the seller, for he will be paid only if the seller is solvent in the future at the time the check becomes payable. It does not matter that the extension of credit is brief, for credit is credit even if extended for only one hour. See, e.g., National City Bank v. Hotchkiss, 231 U.S. 50, 58 (1913). The simplest such situation in which acceptance of a check is an

extension of credit is where the check is a post-dated check. A party accepting a post-dated check has extended credit to the date of the check and cannot be regarded as having been paid cash. This principle is recognized in Official Comment 6 to UCC Section 2-511:

"Where the instrument offered by the buyer is not a payment but a credit instrument such as a note or a check post-dated by even one day, the seller's acceptance of the instrument insofar as third parties are concerned, amounts to a delivery on credit * * *."

See also In re Mort Co., 208 F. Supp. 309, 311 (E.D. Pa. 1962); Watchmaker v. Barnes, 259 F. 783, 788 (1st Cir. 1919).

Here, SCC is in the same position as one who has accepted a post-dated check; neither could be paid by presenting the check "immediately to the bank on which it is drawn." In re Mort Co., *supra*, 208 F. Supp. at 311. Both have extended credit to the time at which the check would become payable. The only difference is that the party accepting the post-dated check has extended credit for a stated period of time while SCC in accepting the check on a frozen account extended credit for an indeterminate period of time. The principle of law, however, is the same.

SCC's position at the time it agreed to accept the check on the frozen account is very much like that of a seller who had learned that a check he had accepted was dishonored on presentment. Both knew at that time that they could not obtain

immediate payment on the buyer's check. Both were confronted with the choice of whether to assert a right to undo the transaction by reclaiming or to rely on the hope that the buyer would become able to pay the check at some point in the reasonably near future. Of course, a seller who makes the latter choice extends credit to the buyer, and the dishonored check cases so hold. See Motores de Mexicali v. Bank of America, 227 F.2d 643 (9th Cir. 1955); Security Trust & Savings Bank v. Wm. R. Staats Co., 233 F. 514 (9th Cir. 1916); Engelkes v. Farmers Co-operative Co., 194 F. Supp. 319 (N.D. Iowa 1961). See also Wilson v. Buchenau, 43 F. Supp. 272 (S.D. Cal. 1942). Although the transactions in these cases began as cash transactions, the conduct of the sellers after learning that the checks could not immediately be reduced to cash converted the transactions to credit transactions.

The Motores de Mexicali case is representative. The seller sold five automobiles to the buyer and the buyer gave drafts in payment. After the drafts were dishonored, the seller re-presented them rather than attempting to reclaim the automobiles. The court found that if the transaction had begun as a cash transaction, the seller's conduct in re-presenting the drafts constituted a waiver of the right to cash payment and thereby converted the transaction into one for credit:

"* * * In a cash sale, there are express or implied concurrent conditions of payment and delivery. Such a condition of payment at the same time as title passes, even if included in an original contract of sale, is subject to waiver by conduct. * * * Any conduct which shows an intention to trust to the credit of the purchaser is sufficient. Here the circumstances of the return of the drafts without an attempt to reclaim the property is sufficient to show such reliance." 227 F.2d at 645.

The same principle applies here. Although SCC had the right to receive a certified check, it elected not to enforce that right. It instead took a check drawn on an account it knew to be frozen. It took that check in the hopes that the check might be paid at some point in the future. It took the risk that Weis would be able to pay. It extended credit.

Under its rules SCC was armed to the teeth with creditor's remedies -- liens, powers to demand additional security, assurances and the like. See pp. 29-30, supra. Although keenly aware that Weis was in financial trouble, SCC elected to do business with Weis "in the normal manner" (A87) rather than to exercise these remedies.* Undoubtedly SCC had no desire to be the one to force one of the largest members of the New York Stock Exchange to close its business. But SCC may not have it both ways. "[It] may not continue

* Recently, SCC did exercise its right to require additional security with respect to Franklin National Bank's use of SCC facilities and services (A97).

to hold [its] rights to the goods and at the same time hold the buyer as [its] creditor." Frech v. Lewis, 218 Pa. 141, 142, 67 A. 45, 46 (1907). Having made its decision to extend credit to Weis, SCC cannot now turn around and belatedly claim the status of a cash seller. In Learned Hand's words, SCC has "assumed the chance" and may not back out because the "hazards turned against" it. Smith v. Tostevin, 247 F. 102, 104 (2d Cir. 1917).

C. SCC Cannot Reclaim Because the
Perpall Rule of Reclamation Has
Been Changed by the Uniform
Commercial Code

SCC's reclamation claim is based on the case of In re Perpall,* decided in 1919. Since then, New York has enacted the Uniform Commercial Code ("UCC"), and Perpall is no longer the law of New York.

In Perpall, the court applied to a sale of securities the old common law "reservation or title" doctrine often applied to the sale of goods. This doctrine can be stated as follows: in a "cash sale", title to the property sold did not pass until the condition of payment was fulfilled. Thus, until a check given in payment in a cash transaction was paid, the seller did not part with title to the goods sold.

* 256 F. 758 (2d Cir. 1919).

The reservation of title doctrine relied on in Perpall is substantially limited as to goods in Article 2 of the UCC* and is entirely abrogated as to securities in Article 8. As will be discussed at greater length hereafter, this difference in treatment is not surprising given the greater emphasis on negotiability throughout Article 8.

Section 8-301(1) of the UCC provides in substance that title passes in a securities transaction when the security is delivered:

"Upon delivery of a security the purchaser acquires the rights in the security which his transferor had or had actually authority to convey * * *."

Here, the "delivery" of all the stock in issue was accomplished. Section 8-313 defines when "delivery" occurs. As to securities purchased for Weis' own account, "delivery" occurred when Weis "acquire[d] possession" of the certificates. See UCC § 8-313(1)(a). And as to stock acquired by Weis for the

* Article 2 limits the Perpall doctrine in two ways. First, the right of reclamation of the goods must be exercised within ten days after dishonor of the check or the right will be lost. UCC §2-507; In re Colacci's of America, Inc., 490 F.2d 1118, 1120 (10th Cir. 1974); In re Fairfield Elevator Co., 14 UCC Rep. Serv. 96, 106-107 (S.D. Iowa 1973) (not officially reported); In re Helms Veneer Corp., 287 F. Supp. 840, 843-44 (W.D. Va. 1968). Second, the reclamation right can no longer be asserted against bona fide purchasers of the goods. Compare UCC §2-507 Official Comment 3 and UCC §2-403(1)(c) Official Comment 2, with 2 Williston, Sales §346(a) at 343 (Rev. ed. 1948).

accounts of its customers*, "delivery" to the customers occurred as well.

Under Section 8-313, there are two separate ways in which delivery to a broker can constitute delivery to a customer. First, a security can be delivered in such a way that it is clearly the property of a specific customer, as when the certificate is delivered to the broker with the customer's name on it. See, e.g., UCC Section 8-313 (1)(b). Second, a broker, as the agent of the customer, may receive a security in respect of a customer trade and hold it in bulk segregation (see UCC Section 8-313(1)(a)); such a security has been "delivered" to the customer and the customer is expressly deemed to be the owner of it. See UCC Section 8-313(2). Delivery to Weis customers occurred in this second way.

Since delivery was complete and Weis or its customers were the owners of all stock picked up on May 24, 1973, SCC cannot have title to the securities and therefore has no basis for reclamation. See, e.g., SEC v. John E. Samuel & Co., [1972-73 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,720 (S.D.N.Y. 1973) (not officially reported); Hewitt v. Paine, Webber,

* At the time SCC first sought reclamation, Weis had on hand securities valued at \$1,714,757.39 which had been delivered through SCC on May 24, of which at least \$1,559,576.04 were attributable to customers of Weis (See Stipulation ¶ 16, A29; Stipulation Exh. E, categories 1, 3, 4, 7, 8, A68-A70; Stipulation Exh. D, Note 3, A67).

Jackson & Curtis, 6 UCC Rep. Serv. 388, 151 N.Y.L.J. 85, p. 12, col. 4 (May 1, 1969) (Sup. Ct. N.Y. County 1969) (not officially reported).

In Samuel, a brokerage house took delivery of a security it had purchased and, before paying for it, went into liquidation under SIPA. The selling broker sought reclamation of the security on the ground of non-payment. Judge Gagliardi held that reclamation based upon non-payment was unavailable because title had passed to the bankrupt broker upon delivery:

"Under the provisions of the Code, it is clear that title and rights to securities vest in the purchaser at the time of delivery. Uniform Commercial Code, Sec. 8-301(1)." CCH Fed. Sec. L. Rep. ¶ 93,720, at 93,196-97.

This conclusion is confirmed by analysis of Section 8-315(1), the only section in Article 8 granting reclamation rights. Section 8-315(1) provides:

"Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, may against anyone except a bona fide purchaser reclaim possession of the security * * *," (Emphasis added).

SCC does not assert that the transfer of the securities from SCC to Weis was in any way wrongful. SCC does not claim that it did not intend to transfer the securities

Weis or that the transfer was induced by fraud, misrepresentation or deception.* Rather, there was here a perfectly proper transfer and a subsequent inability to pay. Thus, the statutory source of reclamation rights--Section 8-315--grants no right of reclamation in the circumstances presented here. Since the theoretical underpinning of a reclamation claim in this kind of case--the reservation of title doctrine--is eliminated in Section 8-301, this is hardly surprising.

It is also not surprising that the Perpall rule has been abrogated in securities transactions. Article 8 places much more emphasis on negotiability and free transferability than does Article 2. As the court in Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383, 1385 (D. Colo. 1968), put it,

"Article Eight provides special rules for investment securities, which are meant to ensure rapid and effective negotiation of such instruments* * *."

* SCC's complaint originally contained a second count alleging fraud, but that count has been dismissed with prejudice by stipulation (A29).

Thus, for example, Article 8 gives securities the status of negotiable instruments, thereby giving purchasers of securities more protection than the purchasers of goods. See UCC §8-105(1). The official comment to UCC §8-105(1) explains that Article 8:

" * * * [G]ives to bona fide purchasers of securities rights greater than those they would have if the things bought were chattels or simple contracts." (McKinney 1964).

Indeed, a bona fide purchaser of securities can get good title from a thief, see UCC §8-105; Hollywood National Bank v. IBM, 14 UCC Rep. Serv. 782, 787 (Cal. Ct. App. 1974) (not officially reported), while a bona fide purchaser of goods cannot. See UCC §2-403; Vanleigh Carpet Corp. v. Gene Schoor's Iron Forge, 65 Misc.2d 504, 505, 318 N.Y.S.2d 402, 404 (Civ. Ct. N.Y. County 1971).

The thrust of Article 8 is succinctly summarized in the New York Annotation to the article:

"Article 8 attempts to provide for the ready and easy transfer of securities without excessive investigation of title questions." Annotation to UCC §8-101 (McKinney 1964).

The special transfer of title rules under Article 8 were designed not only to promote fluidity in the securities markets, but also to protect public customers in the event of their broker's bankruptcy--just as the Securities Investor

Protection Act accords special treatment to public investors in such circumstances. Thus, the official comment to Section 8-313 explains that "[t]he affirmative statement [in Section 8-313(2)] that a purchaser is the 'owner' of a security held for him by his broker or constituting part of a fungible bulk provides protection to the customer in the event of the broker's insolvency, to the extent such protection may be provided by State law."

In view of the foregoing, it is hardly surprising that the only post-UCC cases that SCC can cite in support of its contention that Perpall still survives are Article 2 goods cases. These citations are irrelevant to the present case which is controlled by Article 8.

In light of the high premium placed by the Code on easy transferability of securities, it certainly would be a curious result for it to be concluded that Article 8 provides a more liberal reclamation remedy than does Article 2. Yet this is exactly where SCC's position leads. UCC Section 2-507 provides for a 10 day reclamation period for non-payment of the purchase price in a cash sale involving goods. SCC would have this Court believe that Article 8 sanctions a temporally unlimited right of reclamation for the identical situation involving securities.

The Trustee submits that the clear language of Article 8 precludes this anomalous result and that SCC has no right of reclamation under the facts of this case.

Conclusion

For the foregoing reasons, the order appealed from should be affirmed in all respects.

Dated: New York, New York
February 9, 1976

Respectfully submitted,

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ADDENDUM

ADDENDUM OF RELEVANT UNIFORM COMMERCIAL CODE SECTIONS:

§ 8-313. When Delivery to the Purchaser
 Occurs; Purchaser's Broker as
 Holder

- (1) Delivery to a purchaser occurs when
- (a) he or a person designated by him acquires possession of a security; or
 - (b) his broker acquires possession of a security specially indorsed to or issued in the name of the purchaser; or
 - (c) his broker sends him confirmation of the purchase and also by book entry or otherwise identifies a specific security in the broker's possession as belonging to the purchaser; or
 - (d) with respect to an indentified security to be delivered while still in the possession of a third person when that person acknowledges that he holds for the purchaser; or
 - (e) appropriate entries on the books of a clearing corporation are made under Section 8-320.
- (2) The purchaser is the owner of a security held for him by his broker, but is not the holder except as specified in subparagraphs (b), (c) and (e) of subsection (1). Where a security is part of a fungible bulk the purchaser is the owner of a proportionate property interest in the fungible bulk.

* * *

§ 8-315(1). Action Against Purchaser Based
 Upon Wrongful Transfer

- (1) Any person against whom the transfer of a security is wrongful for any reason, including his incapacity, may against anyone except a bona fide purchaser reclaim possession of the security or obtain possession of any new security evidencing all or part of the same rights or have damages.

* * *

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